

STATE OF INDIANA

DEPARTMENT OF LOCAL GOVERNMENT FINANCE



INDIANA GOVERNMENT CENTER NORTH
100 NORTH SENATE AVENUE N1058
INDIANAPOLIS, IN 46204
PHONE (317) 232-3761
FAX (317) 232-8779

TO: Assessing Officials
FROM: Barry Wood, Assessment Division Director *J.B.W.*
RE: Abnormal Obsolescence (Personal Property) Frequently Asked Questions
Date: April 19, 2011

As a follow-up to the March 25, 2011 conference calls on abnormal obsolescence for personal property, listed below are some frequently asked questions:

I am a new assessor. How is abnormal obsolescence claimed on the return?

Abnormal obsolescence is claimed on Line 65 of the Form 103-Long or on Line 61 of the Form 102. A taxpayer calculates the true tax value and then claims this adjustment if he believes he is entitled to it.

How is the adjustment calculated?

50 IAC 4.2-9 provides the definitions of both "Normal Obsolescence" and "Abnormal Obsolescence" and addresses the allowance of the adjustment. 50 IAC 4.2-4-8 covers the calculation of the adjustment and includes two examples. Note that both examples require the establishment of the net realizable value (or market value) of the affected asset.

What if the taxpayer never establishes what the "net realizable value" is but simply develops a factor to reduce the true tax value?

An adjustment that does not establish a net realizable value should be scrutinized and consideration should be given on whether to approve or deny the claimed adjustment. See the Department's August 21, 2009 memorandum for examples of calculations that are not in compliance with the administrative rules [http://www.in.gov/dlgf/files/090821 - Wood Memo - Abnormal Obsolescence and Personal Property Assessments.pdf](http://www.in.gov/dlgf/files/090821_-_Wood_Memo_-_Abnormal_Obsolescence_and_Personal_Property_Assessments.pdf).

Should an assessor simply deny all adjustment claims for abnormal obsolescence since they are mostly likely incorrectly calculated?

No. There are adjustments claimed by taxpayers in the State of Indiana that are in compliance with the administrative rule, therefore, a blanket denial of all claims cannot be supported by law. Assessors are required to review the personal property tax return as a whole. If there are non-compliance issues on the return, those issues should be addressed.

If an assessor does find that an abnormal obsolescence adjustment is not properly calculated, how should the assessor notify the taxpayer?

IC 6-1.1-3-20 requires that notice be given when an assessing official changes a personal property assessment, and IC 6-1.1-16-1 provides the deadlines for when these notices should be given. The timeframes are September 15th or four months from when the form is filed for township assessors, and October 30th or five months from when the return is filed for county assessors or the PTABOA. If an assessing official fails to properly notify the taxpayer of the change by sending a Form 113/PP in a timely manner, the tax bill then serves as the first official notice of the change. Since the tax bill would be mailed after the statutory deadlines, the change could be challenged through the appeals process and may be found invalid. In this case, the assessed value would be changed back to the amount reported by the taxpayer.

Can the assessor simply mail a copy of the DLGF memorandum with a note on it stating that the adjustment is being denied or perhaps mail a Form 113/PP which only states to "See attached memo" as the reason for the change?

The Department recommends that assessing officials include an explanation with the reasoning behind the change. An example of a basic description might be: "Taxpayer failed to identify the causes and to correctly quantify the amount of the abnormal obsolescence adjustment in accordance with 50 IAC 4.2. Please see the attached memorandum for a detailed explanation."

What is an inutility penalty?

An inutility penalty can be used by an appraiser to measure a loss in value for equipment that is being operated at less than its rated or design capability. It can be used to estimate one form of economic obsolescence within the cost approach (one of the three approaches to market value).

There are three types of appraisal depreciation that are traditionally recognized by appraisers. These types are physical deterioration, functional obsolescence, and economic obsolescence. Calculating economic obsolescence with the inutility penalty is just one part of calculating all forms of appraisal depreciation.

When an appraiser begins an appraisal of equipment under the cost approach, he usually starts with the current replacement cost new and then deducts for the loss in value caused by the three types of depreciation. The calculation would be replacement cost new less physical deterioration (from normal wear and tear); less functional obsolescence, if any; less economic obsolescence, if any; equals the fair market value of the equipment.

How can the inutility penalty help the taxpayer with his personal property tax assessment?

The inutility penalty is an integral part of the market value concept and can be used as a part of the entire calculation during an appraisal to arrive at a fair market value (a.k.a. net realizable value in the administrative rule) for the assets in question. If the fair market value of the assets in question is less than the true tax value of them, an abnormal obsolescence adjustment may be warranted.

If functional obsolescence and economic obsolescence are a part of the market value concept, how does abnormal obsolescence relate to them?

Normal obsolescence and abnormal obsolescence are a part of Indiana's true tax value system for the assessment of personal property. Normal obsolescence as defined in 50 IAC 4.2-9-2 includes reductions in value that can be foreseen by a reasonable, prudent businessman. 50 IAC 4.2-9-3 defines abnormal obsolescence and includes examples of catastrophe, unforeseen governmental action, and exceptional technological obsolescence. 50 IAC 4.2-4-8 (b) states that normal obsolescence includes physical, functional and economic obsolescence to the extent that those assets qualify for abnormal obsolescence as defined, and that the true tax value percentages were adjusted to include these types of obsolescence.

In *Harbor Food Plaza, Inc. v. State Bd. of Tax Commissioners*, 638 N.E.2d 898 (Ind. Tax Ct. 1994), the Tax Court held that normal obsolescence adjustments are built into the true tax value percentages and also addresses events that can be reasonably foreseen by a prudent businessman.

May I deny an adjustment where the taxpayer uses the inutility penalty without establishing a net realizable value or a fair market value?

Yes, the August 2009 memorandum lists this method of calculating the adjustment as being one of the incorrect ways. The inutility penalty is a market value concept and should not be solely used in conjunction with Indiana's true tax value system.

How does the loss of revenue or a decrease in demand for a product relate to the abnormal obsolescence adjustment?

In the Indiana Board of Tax Review ("IBTR") decision of *Applied Extrusion Technologies, Inc. v. Vigo County Assessor* (see http://www.in.gov/ibtr/files/Applied_Extrusion_Technologies_84-012-06-1-7-00001.pdf), it is stated that "the unprofitable nature of a business is not a sufficient basis for allowing obsolescence" (Page 11-#29). It was also stated that "financial difficulties caused by increased cost of raw materials, increased competition, and a decrease of its market share" fails to identify that obsolescence exists (Page 12-#34).

While a taxpayer may be able to use this information as a portion of his evidence to identify the cause of the obsolescence, it may or may not be sufficient to establish a prima facie case on its own.

A part of the definition for abnormal obsolescence states that it is nonrecurring in nature. Does this mean that a taxpayer can only have the adjustment for one year?

A taxpayer may claim the abnormal obsolescence adjustment in any year that he can demonstrate that the assets qualify for the adjustment. As market values fluctuate from year to year, so would this calculation.

What is the two-prong test and how does it work?

For a taxpayer to show that he is entitled to receive an adjustment for abnormal obsolescence, he must first identify the cause of obsolescence that he believes is present. Once he is able to prove that the obsolescence

exists (the first prong), he must quantify the amount of the obsolescence that he believes should be applied to the property (the second prong). *Clark v. State Bd. of Tax Commissioners*, 694 N.E.2d 1230 (Ind. Tax Ct. 1998).

Can I deny an abnormal obsolescence adjustment even if a taxpayer has claimed and received it in the past?

The courts have consistently ruled that each tax year stands on its own, so mistakes or errors made on past returns do not have to continue. *Barth, Inc. v. State Bd. of Tax Commissioners*, 699 N.E.2d 800 (Ind. Tax Ct. 1998). In the IBTR decision *Omer & Janet Brewer v. the Addison Township Assessor* (Shelby County) (see <http://www.in.gov/ibtr/files/73-002-03-1-3-00001.pdf>), IBTR Commissioners ruled past assessments that granted obsolescence are not relevant and do not help make the petitioners' case for the assessment year in question. With this question, the county assessor stated that she changed the assessed value so the taxpayer would have the right to file an appeal under IC 6-1.1-15 and challenge that change of assessment. This appeal would be based on the merits of the case for that particular assessment year and not the past history of it.

Can you give us an example of a company qualifying for abnormal obsolescence?

After the September 11, 2001 terrorist attacks, American Airlines, Inc. and American Eagle Airlines, Inc. claimed abnormal obsolescence on their aircraft. The companies were able to identify the cause of obsolescence to be a result of the government action stopping all commercial air travel, decreased demand for flights, and lowered ticket prices. The assessor denied their claim; however, the companies won their appeal before the IBTR.

If you have any questions, contact Assessment Director Barry Wood at 317.232.3762 or Bwood@dlgf.in.gov, or an Assessment Division Field Representative (see <http://in.gov/dlgf/2338.htm#AssessmentFld> for a list of field representatives).